BOC and its affiliates be done at a price that is compensatory would be consistent with the congressional intent behind section 272(b)(5). In *Computer III* and the *Joint Cost Proceeding*, we re-examined our regulatory regime for the provision of enhanced services and replaced the *Computer II* requirements with a series of nonstructural safeguards, including affiliate transactions rules. In the *NPRM*, we invited comment on whether our affiliate transactions rules, incorporating some of the changes proposed in the Commission's *Affiliate Transactions NPRM* to provide greater protection against cross-subsidization, would be necessary or sufficient to ensure compliance with the "arm's length" requirement of section 272(b)(5).[270]

112. In the *NPRM*, we sought comment on whether and, if so, how we should amend our rules to address section 272(b)(5)'s requirement that all transactions be "reduced to writing and available for public inspection."[271] We also asked whether Internet access to information about these transactions would be sufficient to comply with the "public inspection" requirement and whether we need to adopt safeguards to protect any confidential or sensitive information contained in these publicly available documents.

113. In the *NPRM*, we tentatively concluded that a "request" by an affiliate to its BOC for telephone exchange service or exchange access constitutes a "transaction" within the meaning of section 272(b)(5) which must be "reduced to writing and available for public inspection."[272] We invited comment on this tentative conclusion and asked whether we need to adopt safeguards to protect any confidential or sensitive information related to these types of transactions.

Comments:

114. The BOCs generally contend that we need not prescribe any particular accounting methods to ensure that the "arm's length" requirement of section 272(b)(5) is met.[273] In contrast, MCI argues that our existing affiliate transaction rules, without modification, do not satisfy the "arm's length" requirement because the existing rules give the BOCs too much latitude in valuing their affiliate transactions.[274] MCI and AT&T assert that

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[270] Id. at 9089 para. 73. See Affiliate Transactions Notice, 8 FCC Rcd 8071.

[271] NPRM, 11 FCC Rcd at 9089 para. 74. 47 U.S.C. § 272(b)(5).

[272] NPRM, 11 FCC Rcd at 9089 para. 75. 47 U.S.C. § 272(b)(5).

[273] See Ameritech Comments at 14; Bell Atlantic Comments at 13; BellSouth Comments at 23; PacTel Comments at 2; USTA Comments at 22; US West Comments at 2; NYNEX Reply at 13.

[274] MCI Comments at 16.

we should adopt the modifications to the existing affiliate transactions rules proposed in the *Affiliate Transactions NPRM*.[275] TRA maintains that in order to successfully demonstrate satisfaction of the "arm's length" requirement of section 272(b)(5), a BOC must be able to provide evidence that the terms and conditions of its transactions with affiliates are comparable to the terms and conditions that would have been secured from non-affiliates.[276] Accordingly, TRA suggests that we should require each BOC to accumulate and retain information regarding affiliate transactions.[277]

115. TIA contends that section 272(b)(5)'s requirement that affiliate transactions be conducted on an "arm's length basis" requires that all transfers of assets or services between a BOC and its affiliate required under section 272(a) must occur at a price that is "compensatory."[278] TIA and TRA argue that the affiliate transactions rules, with the modifications proposed in the *NPRM*, would help ensure that BOCs are fully compensated for any goods or services provided to an affiliate and that BOCs pay reasonable prices for any goods or services procured from an affiliate.[279] Several of the BOCs assert that because the Commission, in its *Computer III* decision, retained the notion of compensatory pricing in Parts 32 and 64, existing affiliate transactions rules already ensure that such transactions are conducted at compensatory prices.[280]

116. MCI argues that section 272(b)(5)'s requirement that transactions be "reduced to writing and available for public inspection" indicates that Congress contemplated vigorous involvement by interested third parties in deterring cross-subsidization and discriminatory activity by BOCs.[281] Accordingly, MCI suggests that BOCs should be required to provide to the Commission and make publicly available a complete list of transaction activities with their interLATA and manufacturing affiliates on a periodic basis, at least quarterly, specifying all contracts, arrangements, and other agreements between the BOC and its affiliates, providing a

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275 AT&T Comments at 12-13; MCI Comments at 21. See also TRA Comments at 8.

276 TRA Comments at 7.

277 Id. at 8. See also TIA Reply at 12-13.

278 TIA Reply at 11.

279 Id.; TRA Comments at 9.

280 PacTel Comments at 18; USTA Comments at 22. See also US West Comments at 13.

281 MCI Comments at 29-30.

description of the asset or service transferred, the transfer price, and the method of valuation.[282]

117. The BOCs generally argue that there is no need for the Commission to amend its rules to address section 272(b)(5)'s requirement that transactions be "reduced to writing and available for public inspection" because the Commission's rules already require carriers to disclose certain information regarding affiliate transactions in section V of their cost allocation manuals.[283] MCI, however, asserts that the "reduced to writing and available for public inspection" requirement of section 272(b)(5) cannot be satisfied by the Commission's existing cost allocation manual filing requirements because the information in the BOCs' cost allocation manuals is not sufficiently detailed.[284]

118. MCI and Worldcom contend that Internet access to information about transactions between BOCs and their affiliates required under section 272(a) would be sufficient to comply with section 272(b)(5)'s requirement that transactions be "reduced to writing and available for public inspection."[285] Although US West agrees that Internet access would meet the obligations of section 272(b)(5), US West maintains that we should not require companies to post internal documents on the Internet because the companies could not monitor who was inspecting the documents.[286] In contrast, TRA and APCC argue that, while the Commission should encourage Internet access to information concerning affiliate transactions, Internet access alone does not satisfy section 272(b)(5)'s "available for public inspection" requirement because Internet access is still unavailable to many.[287] USTA asserts that we should simply require that documents related to affiliate transactions be available at a location designated by the carrier.[288] Several parties oppose a rule that would allow BOCs to choose a single location where documents concerning affiliate transactions are available to the public

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[282] Id. at 30; MCI Reply at 11. See also TIA Reply at 12-13.

[283] Ameritech Comments at 23; PacTel Comments at 19; SBC Comments at 45; US West Comments at 13. See also PacTel Comments at 19-20. 47 C.F.R. § 64.903(a)(4).

[284] MCI Reply at 11. See also Worldcom Reply at 16.

[285] MCI Comments at 30; Worldcom Comments at 24-25; MCI Reply at 11. See also TIA Reply at 13, n. 29.

[286] US West Comments at 13. See also Ameritech Reply at 19.

[287] APCC Comments at 25; TRA Comments at 9-10.

[288] USTA Comments at 23. See also MCI Reply at 12.

and contend that such a rule would severely limit a third party's ability to gain access to such information.[289]

119. With regard to concerns about the protection of confidential or sensitive information contained in any documents that BOCs make "available for public inspection" in accordance with section 272(b)(5), APCC contends that pricing information based upon tariffed rates, prevailing market prices, or fair market value should not involve proprietary information.[290] According to APCC, only pricing based upon fully distributed costs might be considered proprietary, and, for the sake of ensuring arm's length transactions, the Commission should impose a heavy burden on BOCs and independent local exchange carriers of demonstrating that such information warrants proprietary status.[291] TIA asserts that to the extent that relevant documents contain proprietary information, the Commission should use reasonable non-disclosure agreements to ensure that such information is not misused.[292] The BOCs urge the Commission to adopt and apply the standards for the protection of confidential information are contained in the Comments of the Joint Parties in response to the Commission's *Confidential Information Notice*.[293]

120. Several interexchange carriers support our tentative conclusion that a request by an affiliate to its BOC for telephone exchange service or exchange access constitutes a "transaction" within the meaning of section 272(b)(5) which must be "reduced to writing and available for public inspection."[294] TRA asserts that only by requiring all requests by affiliates to their BOCs for telephone exchange service or exchange access to be available for public inspection will the public and the Commission be able to evaluate the BOCs' compliance with section 272(e)(1).[295] US West disagrees with our tentative conclusion and contends that only

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289 See APCC Reply at 8; TIA Reply at 12; Worldcom Reply at 16.

290 APCC Comments at 23.

291 Id. See also MCI Comments at 32; Worldcom Comments at 24-25; APCC Reply at 8; Worldcom Reply at 16.

292 TIA Reply at 13, n. 29.

293 Ameritech Comments at 23; PacTel Comments at 19; SBC Comments at 46; USTA Comments at 23; US West Comments at 13. In the Matter of Examination of Current Policy Concerning the Treatment of Confidential Information Submitted to the Commission, Notice of Inquiry and Notice of Proposed Rulemaking, GC Docket No. 96-55, FCC 96-109 (rel. March 25, 1996) ("Confidential Information Notice").

294 AT&T Comments at 13; MCI Comments at 31; Worldcom Comments at 25.

295 TRA Comments at 10.

once the BOC and its affiliate have agreed upon the terms and conditions for telephone exchange and exchange access does the agreement constitute a "transaction."[296]

Discussion:

121. We decline to adopt *Computer II* type requirements in order to implement section 272(b)(5). We agree with several of the BOCs that because our *Computer III* decision retained the concept of compensatory pricing in Parts 32 and 64, our existing affiliate transactions rules already ensure that affiliate transactions are conducted at compensatory prices.[297] We conclude that our affiliate transactions rules, developed in *Computer III* and the *Joint Cost Proceeding*, with some of the changes proposed in the Commission's *Affiliate Transactions NPRM*, will ensure compliance with the "arm's length" requirement of section 272(b)(5). We discuss the requirements of these rules in section IV.B.1.b.ii. below.

122. To satisfy section 272(b)(5)'s requirement that transactions between section 272 affiliates and the BOC of which they are an affiliate be "reduced to writing and available for public inspection," we require the separate affiliate, at a minimum, to provide a detailed written description of the asset or service transferred and the terms and conditions of the transaction on the Internet within 10 days of the transaction through the company's home page. The broad access of the Internet will increase the availability and accessibility of this information to interested parties, while imposing a minimal burden on the BOCs. We require that the description of the asset or service and the terms and conditions of the transaction should be sufficiently detailed to allow us to evaluate compliance with our accounting rules. This information must also be made available for public inspection at the principal place of business of the BOC.[298] The information made available at the principal place of business of the BOC must include a certification statement identical to the certification statement currently required to be included with all Automated Reporting and Management Information System ("ARMIS") reports.[299] Such certification statement declares that an officer of the BOC has examined the submission and that to the best of the officer's knowledge all statements of fact contained in the submission are true and the submission is an accurate statement of the affairs

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[296] US West Comments at 14.

[297] PacTel Comments at 18; USTA Comments at 22. See also US West Comments at 13.

[298] The principal place of business refers to the corporate headquarters of a BOC, not the RBOC corporate headquarters or the corporate headquarters of the BOC's holding company.

[299] See, e.g., Automated Reporting Requirements for Certain Class A and Tier 1 Telephone Companies (Parts 31, 43, 67, and 69 of the FCC's Rules), Order, CC Docket No. 86-182, 4 FCC Rcd 1040, 1124 (Com. Car. Bur. 1989).

of the BOC for the relevant period.[300] Information contained in a BOC's cost allocation manual is not sufficiently detailed to satisfy section 272(b) because the BOC's cost allocation manual contains only a general description of the asset or service and does not describe all of the terms and conditions of each transaction. While section 272(b)(5) requires BOCs to reduce their transactions to writing and make them "available for public inspection," we will continue to protect the confidential information of BOCs, as well as other incumbent local exchange carriers.[301]

123. We recognize a need to clarify how the requirements of section 273(e)(5) relate to the full scope of a BOC's reporting obligations under section 272(b)(5) of the Act. Section 273(e)(5)'s general mandate that BOCs "shall protect the proprietary information submitted for procurement decisions from release not specifically authorized by the owner of such information" neither curtails nor obviates section 272(b)(5)'s requirement that transactions between BOCs and their manufacturing affiliates be reduced to writing and made available for public inspection. Section 273(e)(5) addresses a BOC's duties solely with regard to submissions for procurement decisions, either by an affiliate or a third party. Only after a BOC consummates a transaction with a manufacturing affiliate would the reporting requirements of section 272(b)(5) trigger. Transactions between BOCs and third parties are not subject to the reporting requirements of section 272(b)(5). Section 272(b)(5)'s requirement that BOCs reduce their transactions with manufacturing affiliates to writing and make them available for public inspection permits the Commission and competitors to ensure that the BOCs are complying with the nondiscrimination and accounting safeguards of the Act.

124. We decline to adopt our tentative conclusion that a "request" by an affiliate to its BOC for telephone exchange service or exchange access constitutes a "transaction" within the meaning of section 272(b)(5) which must be "reduced to writing and available for public inspection."[302] We note, however, that once the BOC and its affiliate have agreed upon the terms and conditions for telephone exchange and exchange access such agreement would constitute a "transaction."[303] For clarification, we also find that agreements between a BOC and its affiliate for the provision of unbundled elements and facilities pursuant to explicit terms and conditions also constitutes a "transaction."

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300 Id.

301 We are currently examining the protection of confidential information in CC Docket No. 96-55.

302 AT&T Comments at 13; MCI Comments at 31; Worldcom Comments at 25.

303 US West Comments at 14.

i. Prevailing Company Prices

125. In the *NPRM*, we asked whether affiliate transactions conducted "on an arm's length basis" would necessarily entail the same marketing efforts and transactional costs as transactions with non-affiliates.[304] We also solicited comment on the impact that any differences in marketing efforts and transactional costs might have in accurately valuing affiliate transactions and how such differences should affect our use of the prevailing price method to record affiliate transactions between the BOCs and their affiliates engaged in activities described in section 272(a)(2).

126. We also sought comment on whether we should eliminate the use of the prevailing price method as a valuation method for recording affiliate transactions between the BOCs and their affiliates engaged in activities described in section 272(a)(2).[305] The prevailing price describes the price at which a company offers an asset or service to the general public.[306] A carrier subject to our current affiliate transactions rules records non-tariffed assets or services at their prevailing prices if such prices exist. Prevailing price currently represents one component in the hierarchy of methods for valuing transactions between a carrier and its affiliate. A carrier subject to our current affiliate transactions rules uses one of the following methods to value asset transfers for regulated accounts: (1) tariffed rates,[307] (2) prevailing company prices,[308] (3) net book cost,[309] or (4) estimated fair market value.[310] These valuation methods apply when the carrier is either the purchaser or seller of the asset according to the following set of rules. First, carriers must record each asset transferred to an affiliate pursuant to tariff at the tariffed rate. Second, if no tariff exists and an affiliate that transfers or sells an asset to its regulated carrier also sells the same kind of asset to third parties at a generally available price, then the carrier must record the asset sale or transfer at that prevailing company price. Non-tariffed assets that are sold or transferred by the carrier to its affiliates and are sold to third parties at a generally available price, must also be recorded by

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304 NPRM, 11 FCC Rcd at 9092 para. 80.

305 Id. at 9093 para. 82.

306 See Affiliate Transactions Notice, 8 FCC Rcd at 8077-80 paras. 15-22.

307 47 C.F.R. § 32.27(c).

308 Id. §§ 32.27(b), 32.27(c).

309 Net book cost refers to costs less all applicable valuation reserves.

310 47 C.F.R. §§ 32.27(b), 32.27(c).

the carrier at that price. Third, all other asset transfers must be recorded at the higher of net book cost and estimated fair market value when the carrier is the seller, and at the lower of net book cost and estimated fair market value when the carrier is the buyer (*i.e.*, from the affiliate).[311] The United States Court of Appeals for the District of Columbia Circuit affirmed the valuation methods for asset transfers, finding them "reasonably designed to prevent systematic abuse of ratepayers."[312]

127. In comparison to our method for valuing asset transfers, carriers must record transactions involving services in their Part 32 accounts according to one of three valuation methods: (1) tariffed rates,[313] (2) prevailing company prices,[314] or (3) fully distributed cost.[315] These valuation methods are applied when the carrier is either the purchaser or seller of the service according to the following set of rules. First, carriers must record services provided to an affiliate pursuant to tariff at the tariffed rate. Second, if no tariff exists and a carrier transfers or sells a service to its regulated affiliate that it also provides to third parties, the carrier must record the transaction at the prevailing company price. Non-tariffed services that are sold or transferred by an affiliate to its regulated carrier and are also sold to third parties at a generally available price, must also be recorded by the carrier at that price. Third, all other services provided to affiliates must be recorded at the service provider's fully distributed costs.[316]

Comments:

128. TRA argues that a company transacting business with its affiliate will benefit from lower or non-existent marketing costs because the company is already known to the affiliate, thereby minimizing transactional costs during affiliate transactions.[317] Therefore, according to TRA, if a BOC is permitted to use prevailing price to value a transaction with its affiliate, both parties will be able to transfer all avoided marketing and transactional costs to

311 Id.

312 Southwestern Bell Corp. v. FCC, 896 F.2d 1378, 1378 (D.C.Cir. 1990).

313 47 C.F.R. § 32.27(c).

314 Id. § 32.27(b), 32.27(c).

315 Id. § 32.27(d).

316 Id.

317 TRA Comments at 12.

their advantage.[318] Several other parties, including PacTel and Sprint, contend that the idea that an entity operating in a highly competitive market does not need to devote the same amount of effort and resources to win business from its affiliates as it does from non-affiliates is incorrect.[319] In particular, Sprint maintains that "in a competitive market with a variety of suppliers offering a plethora of price and service options, an entity has to work just as hard to sell to its affiliates as it does to non-affiliates. Otherwise, its affiliates will look to other suppliers."[320]

129. Several parties support the Commission's proposal to eliminate the use of the prevailing price method to record affiliate transactions between the BOCs and their affiliates engaged in the activities described in section 272(a)(2).[321] These parties contend that the Commission's present prevailing price method is difficult to apply and affords carriers too much discretion.[322] A number of other parties, including the BOCs, AT&T and Sprint, argue against the Commission's proposal to eliminate the prevailing price method.[323] Puerto Rico Telephone, in particular, maintains that the importance of using prevailing prices will increase in the future as interconnection agreements are established and tariffs are eliminated.[324] APCC argues that the prevailing price method is more objective than fair market value or fully distributed costs.[325] SBC and US West argue that if we eliminated the prevailing price method, BOCs would be required to conduct fully distributed costs studies of their affiliate transactions even if all of the products and services involved in the transaction are available to third parties at a prevailing price.[326] BellSouth contends that the elimination of the prevailing

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[318] Id. See also Worldcom Reply at 15.

[319] PacTel Comments at 27; Sprint Comments at 12; PacTel Reply at 15. See also GTE Comments at 5; SBC Comments at 33.

[320] Sprint Comments at 12.

[321] CTA Comments at 16; MCI Comments at 24; TRA Comments at 13; Florida PSC Reply at 2; TIA Reply at 19-20.

[322] See CTA Comments at 16; MCI Comments at 24; TRA Comments at 13; TIA Reply at 19-20.

[323] AT&T Comments at 15; NYNEX Comments at 28; Puerto Rico Telephone Comments at 5; Sprint Comments at 12; GTE Reply at 3.

[324] Puerto Rico Telephone Comments at 5.

[325] APCC Comments at 27-28.

[326] SBC Comments at 31; US West Comments at 16.

price valuation method would impose significant administrative costs and burdens on the BOCs with virtually no additional protection for customers.[327]

130. AT&T recognizes the difficulties in determining prevailing price; AT&T, however, maintains that rather than eliminating prevailing price, the Commission should modify its rules so that prevailing price is only available if the affiliate sells a substantial percentage by quantity of that product line to nonaffiliated customers.[328] TIA contends that the Commission should adopt a rule that allows a carrier to value affiliate transactions at prevailing price only when the affiliate can demonstrate that it has made substantial sales of the same product to third parties.[329] Sprint argues that sales to third parties cannot reliably be used to establish prevailing price when an affiliate operates in a non-competitive market or a market where there are few third-party transactions.[330] In addition, TRA argues that if the percentage of third-party business is small, there will be little assurance that an affiliate transaction would truly be conducted at arm's length.[331]

131. NYNEX contends that the adoption of a clear definition of what constitutes prevailing price would clarify our rules and establish consistency.[332] In particular, NYNEX argues that if the Commission should determine that some baseline percentage of third-party sales is necessary to establish prevailing price, then the Commission should adopt a baseline percentage much less than the 75 percent figure proposed in the Commission's *Affiliate Transactions Notice*.[333] MCI maintains that the prevailing price method is particularly difficult to apply because of the difficulties in determining whether a substantial portion of an affiliate's production is being provided to third parties.[334] MCI argues that in order to correct such

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[327] BellSouth Comments at 31.

[328] AT&T Comments at 15. See also SBC Reply at 15-16.

[329] TIA Reply at 21 n. 54. See also PacTel Comments at 28.

[330] Sprint Comments at 13.

[331] TRA Comments at 13. See also BellSouth Reply at 10-11.

[332] NYNEX Comments at 28.

[333] Id. But see BellSouth Comments at 30-31 (arguing that the Commission need not establish a fixed percentage of sales to determine prevailing price); SBC Reply at 16 (arguing that the Commission need not establish an arbitrary baseline percentage to establish prevailing price). Affiliate Transactions Notice, 8 FCC Rcd at 8080 para. 22.

[334] MCI Comments at 23-4; MCI Reply at 10.

difficulties, the Commission would need to apply any baseline percentage necessary to establish prevailing price on a product-by-product basis.[335]

Discussion:

132. We find unpersuasive TRA's argument that a company transacting business with its affiliate will significantly benefit from lower or non-existent marketing costs because the company is already known to the affiliate. In competitive markets, companies devote significant resources to attracting and retaining customers through sales presentations, advertising campaigns, volume purchase discounts, or long-term commitments.[336] In addition, any potential benefits to a carrier in transacting business with its affiliate are diminished to some extent by the system and transaction costs incurred in complying with our affiliate transactions rules. Accordingly, we conclude that any differences in marketing efforts and transactional costs that might exist are not significant and should not affect our use of the prevailing price method to record affiliate transactions.

133. We decline to adopt our proposal to eliminate prevailing price as a valuation method under our affiliate transactions rules. Initially, we selected prevailing price as a valuation method because we believed that those prices would provide a reliable measure of fair market value.[337] Our experience in auditing carriers' application of the prevailing price method to determine how inter-affiliate transfers of services should be recorded has revealed difficulties in determining what is necessary to establish a prevailing price.[338] Rather than rejecting prevailing price valuation, however, we conclude that these difficulties are best addressed by modification and clarification of the prevailing price valuation method.[339]

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335 MCI Comments at 24.

336 See Sprint Comments at 12.

337 See generally Joint Cost Reconsideration Order, 2 FCC Rcd at 6296 para. 120; Joint Cost Order, 2 FCC Rcd at 1336 para. 295.

338 See NPRM at 9092-93 para. 81.

339 Our decision to modify and clarify the prevailing price method rather than to eliminate prevailing price as an acceptable valuation method recognizes the BOCs contention that elimination of prevailing price would impose additional burdens on subject carriers. BellSouth Comments at 31; SBC Comments at 31; US West Comments at 16; Letter from Maurice P. Talbot, Jr., Executive Director-Federal Regulatory, BellSouth, to William F. Caton, Acting Secretary, FCC, filed November 12, 1996 (commemorating an ex parte meeting between the Commission's Common Carrier Bureau of the Commission and representatives from all of the BOCs); Letter from Jane Knox, Director-Federal Regulatory, SBC, to William F. Caton, Acting Secretary, FCC, filed October 15, 1996 (commemorating an ex parte meeting between the Common Carrier Bureau's

134. One of the difficulties we have identified with respect to prevailing price valuation has been determining when carriers should apply the prevailing price method to transfers of particular assets or services. The mere offering of an asset or service to unaffiliated entities is not sufficient to establish a prevailing price. A substantial quantity of business must be conducted with unaffiliated third parties in order to establish a true prevailing price.[340] Specifically, if the percentage of third-party business is small, there can be no assurance that the price agreed upon by the carrier and its affiliate represents the true market price, thus raising legitimate questions as to whether the parties actually negotiated "on an arm's length basis."[341] In such situations, the use of prevailing prices to value transactions could permit an affiliate to charge inflated prices to its affiliated regulated carrier, possibly leading to higher prices for customers purchasing the regulated services.

135. Our previous rules did not clarify the meaning of a "substantial" amount of third-party business for the purpose of establishing a true prevailing price. We agree with MCI that without clarification of the meaning of "substantial" in this context, the retention of the prevailing price method places a difficult burden on the Commission in verifying compliance with the affiliate transactions rules.[342] Accordingly, we find that a clear definition of what constitutes prevailing price is necessary to clarify our affiliate transactions rules and establish consistency.[343] We conclude that annual sales, as measured by quantity, of greater than 50 percent of a particular product or service to third parties must occur to satisfy the requirement that there be a "substantial" amount of outside business in order to produce a true prevailing price for that particular product or service. We find that third-party sales of 50 percent or less are evidence of the fact that a party's primary function is to provide products or services to affiliates, rather than to outside market participants, and, consequently, those sales to unaffiliated entities are not sufficient to establish a true prevailing price. We note that our modifications here to clarify the prevailing price method apply to all assets and services transactions governed by our affiliate transactions rules.

136. We conclude that the 50 percent threshold established in this Order must be applied on a product-by-product and service-by-service basis, rather than on a product-line or

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Accounting and Audits Division and representatives from all of the BOCs except NYNEX).

340 Affiliate Transactions Notice at 8077 para. 15.

341 47 U.S.C. § 272(b)(5).

342 MCI Comments at 23-4.

343 See id.; NYNEX Comments at 28.

service-line basis.[344] Application of the 50 percent threshold on a product-line or service-line basis would give carriers the incentive to define product lines and service lines as broadly as possible in order to be able to value as many transactions as possible at prevailing price. Additionally, if the 50 percent threshold were applied to a product line or service line, then products or services that are sold to third parties in quantities of 50 percent or less could be grouped in the same line with different products or services that are sold primarily to third parties, qualifying the entire line of products for prevailing price valuation. Such grouping would allow products or services for which no true prevailing price exists to be valued by a carrier at a fabricated prevailing price to the harm of ratepayers if the cost or market value of such products or services is actually different from this fabricated prevailing price. Moreover, verifying that product lines and service lines have been properly defined would place a significant burden on the Commission.

137. We do allow one exception to our rule that only a product or service for which annual sales to third parties, measured by quantity sold, exceed 50 percent of total sales of that product or service may be recorded by carriers at prevailing price. Section 272 requires BOCs to charge their section 272 affiliates the same rates as unaffiliated third parties for facilities, services, and information.[345] Because the rates for services subject to section 272 must be made generally available to both affiliates and third parties, we adopt a rebuttable presumption that these rates represent prevailing company prices. Accordingly, products and services subject to section 272 need not meet the 50 percent threshold in order for a BOC to record the transaction involving such products and services at prevailing price.

ii. Valuation Methods for Assets and Services.

138. In the *Joint Cost Order*, we did not prescribe uniform valuation methods for all affiliate transactions.[346] The Part 64 cost allocation rules direct subject carriers to use different methods to value transfers of assets and transfers of services.[347] In the *NPRM*, we proposed to direct carriers to apply the valuation method currently prescribed for asset transfers to service

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[344] See MCI Comments at 24.

[345] See 47 U.S.C. §§ 272(c)(1), 272(e).

[346] See Joint Cost Order, 2 FCC Rcd at 1336-37 paras. 294-301.

[347] We discuss the valuation methods contained in the existing current affiliate transactions rules in section IV.B.1.b.ii. of this Order.

transfers.[348] The *NPRM* did propose, however, to continue to define the cost of asset transfers in terms of net book cost and the cost of service transfers in terms of fully distributed costs.[349] We sought comment on whether these proposed modifications to the affiliate transactions rules would meet the objectives of section 272 better than the existing rules. We asked commenters to discuss whether, and under what circumstances, we should allow carriers and their affiliates to use any alternative valuation methods. We also sought comment on how the elimination of a sharing obligation from our price cap rules would affect the validity of our tentative conclusion in the *Affiliate Transactions NPRM* that our treatment of the provision of services that are neither tariffed nor subject to prevailing company prices may reward a carrier's imprudent acts of buying services from affiliates for more than, and selling services to affiliates for less than, fair market value.[350]

139. Section 272(e)(3) requires that "[a] Bell operating company and an affiliate that is subject to the requirements of section 251(c) . . . shall charge the affiliate described in subsection (a) or impute to itself (if using the access for its provision of its own services), an amount for access that is no less than the amount charged to any unaffiliated interexchange carriers for such service."[351] Section 272(e)(4) states that "[a] Bell operating company and an affiliate that is subject to the requirements of section 251(c) . . . may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated."[352] We also sought comment on how these requirements should affect our rules for implementing the "arm's length" requirement of section 272(b)(5).[353] In addition, we invited comment on whether we should adopt specific accounting procedures to address the difference, if any, between the rates charged by BOCs

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[348] NPRM, 11 FCC Rcd at 9091 para. 78. We note that the services we are discussing here are not tariffed.

[349] The net book cost of an asset includes all costs necessary to put the asset in place for its intended purpose. The fully distributed cost of a service includes all direct costs as well as the proper share of joint and common costs necessary to fully perform the service. Accordingly, the net book cost of an asset is comparable to the fully distributed cost of a service.

[350] See Joint Cost Order, 2 FCC Rcd at 1336-37 paras. 294-301.

[351] 47 U.S.C. § 272(e)(3).

[352] Id. § 272(e)(4).

[353] NPRM, 11 FCC Rcd at 9092 para. 79.

when they provide interLATA or intraLATA facilities or services on a separated basis and "the costs [that would be] appropriately allocated" for the underlying facilities or services.[354]

Comments:

140. Many commenters, including AT&T, Wisconsin PSC and GSA, support the Commission's proposal to conform the valuation methods under the affiliate transactions rules governing service transfers and asset transfers.[355] Several of these commenters argue that the current valuation method for services does not adequately ensure compliance with section 272(b)(5)'s "arm's length" requirement because it rewards a carrier for buying services from affiliates at more than, and selling them to affiliates for less than, fair market value.[356] AT&T further contends that our current valuation rules, by allowing a carrier to sell services for less than fair market value, would allow carriers to violate section 254(k)'s prohibition against cross-subsidizing competitive operations.[357]

141. The BOCs and Sprint oppose the Commission's proposed change to the affiliate transactions rules.[358] They argue that any attempt to establish fair market value for services would prove inherently subjective.[359] USTA and several BOCs note that in our reconsideration of the *Joint Cost Order*, we rejected a similar proposal to utilize estimates of fair market value for the transfer of services, stating that "such a valuation standard is fraught with potential for abuse, and would be difficult to monitor."[360] PacTel argues that section 272(e)(2)'s nondiscrimination requirement has eliminated any potential for harm.[361] PacTel

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[354] Id.

[355] AT&T Comments at 14; GSA Comments at 6; Wisconsin PSC Comments at 6. See also CTA Comments at 16; MCI Comments at 21-22; TIA Reply at 16; TRA Comments at 11; Washington Reply at 5; Worldcom Comments at 25.

[356] See, e.g., APCC Comments at 26; AT&T Comments at 14; GSA Comments at 6; MCI Comments at 21; TIA Reply at 16.

[357] AT&T Comments at 14.

[358] See, e.g., NYNEX Comments at 21; Sprint Comments at 14; NYNEX Reply at 13. See also Puerto Rico Telephone Comments at 5.

[359] See, e.g., Ameritech Comments at 16-17; PacTel Comments at 22; Sprint Comments at 14; SBC Reply at 14.

[360] BellSouth Comments at 24-29; NYNEX Reply at 15; USTA Comments at 18.

[361] PacTel Comments at 21.

further contends that the Commission should not require fair market valuation for governance functions provided to carriers by their regional holding companies.[362] BellSouth contends that application of the "asset transfer rules" to transactions involving services will require the BOCs and their affiliates to incur hundreds of millions of dollars in increased annual administrative cost.[363]

142. APCC argues that the Commission should adopt a rule that requires carriers to value services at the lower of fully distributed costs and estimated fair market value when it is the purchaser with a price ceiling set at prevailing price.[364] APCC contends that prevailing price serves as a check to ensure that the carrier has not overstated the price determined using the lower of fully distributed costs and estimated fair market value, preventing an affiliate from charging its affiliated carrier more than a competitor.[365] APCC similarly argues that the Commission should set a price floor at prevailing price when the carrier is the seller.[366]

143. AT&T argues that with regard to the requirements of section 272(e)(3), the BOC must charge its affiliate, at a minimum, the tariffed rate for access services.[367] AT&T maintains that the Commission should require a BOC's interLATA affiliate to reflect these access charges in end-user rates, at least as long as the BOC retains dominance in the provision of exchange access services. AT&T asserts that the Commission should impose price floors for interLATA services at a level equal to a BOC's access charges plus the incremental cost of the non-access portions of the service to ensure an affiliate's imputation of access charges.[368]

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[362] Id. at 25.

[363] BellSouth Comments at 32-33 (citing a study by Theodore Barry and Associates claiming that the application of the proposed rule to three BellSouth affiliates would result in annual increased administrative costs of more than $14.4 million).

[364] APCC Comments at 28.

[365] Id.

[366] Id.

[367] AT&T Comments at 10.

[368] Id. at 11.

Discussion:

144. In the *Joint Cost Proceeding*, we considered identical valuation methods for assets and services. These methods would have required carriers to record all affiliate transactions that are neither tariffed nor subject to prevailing company prices at the higher of cost and estimated fair market value when it is the seller, and at the lower of cost and estimated fair market value when the carrier is the purchaser. As USTA and several BOCs point out,[369] however, the *Joint Cost Order* ultimately did not prescribe uniform valuation methods for all affiliate transactions.[370] In the case of services, the *Joint Cost Order* requires carriers to record all non-tariffed services other than those having prevailing company prices at the providers' fully distributed costs while all nontariffed assets other than those having prevailing company prices must be recorded at the higher of cost and estimated fair market value when it is the seller, and at the lower of cost and estimated fair market value when the carrier is the purchaser.[371]

145. The Commission based its decision not to apply the asset transfer rules to services on commenters' suggestions that those rules would reduce or eliminate "the incentive for certain service activities to be provided in a more efficient manner than that which the regulated entity would alone achieve."[372] Since the adoption of the affiliate transactions rules, we have adopted price cap regulation that gives the largest incumbent local exchange carriers efficiency incentives far stronger than those the valuation methods for affiliate services sought to preserve.[373] These changes in regulation have caused us to re-evaluate the effect of our valuation methods for affiliate services on carrier incentives. That re-evaluation makes clear that our current treatment of services that are neither tariffed nor subject to prevailing

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369 BellSouth Comments at 24-29; NYNEX Reply at 15; USTA Comments at 18.

370 See Joint Cost Order, 2 FCC Rcd at 1336 paras. 294-99.

371 See id.

372 Id. at para. 294.

373 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd 6786, 6807 para. 165 (1990) ("LEC Price Cap Order"), Erratum, 5 FCC Rcd 7664 (Com. Car. Bur. 1990), modified on recon., 6 FCC Rcd 2637 (1991) ("LEC Price Cap Reconsideration Order"), aff'd, National Rural Telecom Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993), (citing Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Notice of Proposed Rulemaking, 2 FCC Rcd 5208 (1987)); Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195 (1988); Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989) ("AT&T Price Cap Order"), Erratum, 4 FCC Rcd 3379 (1989), modified on recon., 6 FCC Rcd 665 (1991) ("AT&T Price Cap Reconsideration Order"), remanded, AT&T v. FCC, 974 F.2d 1351 (D.C.Cir. 1992), vacated, Order and Notice of Proposed Rulemaking, 8 FCC Rcd. 3715 (1993).

company prices made generally available[374] may in fact reward a carrier that acts imprudently when buying services from affiliates for more than, and selling services to affiliates for less than, fair market value.[375] Our current valuation rules require a carrier to record services sold to nonregulated affiliates at the carrier's fully distributed cost. These rules apply even when the carrier's fully distributed cost for the service is less than the fair market value of that service. Under these circumstances, our current valuation rules result in a smaller profit for the carrier in a service transaction with its nonregulated affiliate than would a similar transaction with a third party for the same service. Our current valuation rules also require a carrier to record services purchased from a nonregulated affiliate at the affiliate's fully distributed cost. These rules apply even when the affiliate's fully distributed cost for the service is greater than the fair market value of that service. Accordingly, our current valuation rules may entice a carrier to pay its nonregulated affiliate more for a service than the carrier would pay a third party for the same service.[376] In either set of circumstances, ratepayers may be harmed if the carrier's smaller profits or increased costs as a result of our services valuation rules are reflected in rates for regulated telecommunications services. Ratepayers and service providers not affiliated with carriers may also be harmed if the valuation methods for affiliate transactions induce carriers and their affiliates to "use services that are not competitive to subsidize services that are subject to competition,"[377] thereby putting service providers not affiliated with the carrier at a competitive disadvantage.

146. We believe that requiring carriers to use the same valuation methods for both services and asset transfers would also reduce the incentive to record an affiliate transaction as a service transfer, rather than an asset transfer, especially in the context of procurement activities. Under our current rules for recording transfers of services, carriers may record services sold to their affiliates at cost even if the fair market value of such services is actually much higher, allowing the carrier's affiliates to take advantage of services at below market

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[374] We discuss the prevailing price method in section IV.B.1.b.i., supra.

[375] See Joint Cost Order, 2 FCC Rcd at 1336-37 paras. 294-301.

[376] Another way this can occur is through chain transactions. Chain transactions are transactions in which an asset, service or product is supplied by either a third party or an affiliate of the carrier first to another affiliate of that carrier and next to the carrier itself. We believe that our current valuation methods for services may enable an affiliate to use chain transactions to pass assets or services to the affiliated carrier at inflated charges. For example, nonregulated affiliate A could buy a product from a third party. A could then sell the product to nonregulated affiliate B at any price (e.g., with a 50 percent profit). B could then sell the product to the affiliated carrier at a price that includes not only its authorized profit, but also the profit earned by A. Because carriers generally value and record such transactions based on the affiliate transactions rules governing service transfers, the transaction would be recorded at fully distributed costs.

[377] 47 U.S.C. § 254(k).

costs to the detriment of the carrier's ratepayers. With respect to the sale of assets, however, carriers must record the sale at the higher of cost or fair market value. Our current rules also allow carriers to record services purchased from their affiliated carriers at cost even if the fair market value of such services is actually much lower, allowing the carrier's affiliates to receive the benefit of higher than market value sales to the detriment of the carrier's ratepayers. In the case of the purchase of an asset, however, carriers must record the purchase at the lower of cost or fair market value. Requiring a carrier to value transfers of services using the same valuation methods currently used for asset transfers would reduce the carrier's ability to value a transfer so that a carrier can pass on to their affiliates any financial advantages flowing from how they choose to characterize the transaction.

147. Because of the concerns identified in the preceding paragraph, we believe that the current rules regarding the valuation of affiliate services may not be consistent with the requirement of section 272(b)(5) that transactions be conducted "on an arm's length basis."[378] The rule we adopt above--requiring carriers to record all affiliate transactions that are neither tariffed nor subject to prevailing company prices at the higher of cost and estimated fair market value when the carrier is the seller or transferor, and at the lower of cost and estimated fair market value when the carrier is the buyer or transferee--appears more likely to ensure that the transactions between carriers and their nonregulated affiliates take place on an "arm's length" basis, guarding against cross-subsidization of competitive services by subscribers to regulated telecommunication services. This rule will conform the valuation methods under the affiliate transactions rules for the provision of services to those methods we currently use to value asset transfers. We continue, however, to define the cost of asset transfers in terms of net book cost and the cost of service transfers in terms of fully distributed costs because the net book cost of an asset is comparable to the fully distributed cost of a service.

148. We do allow one exception to our rule conforming the valuation methods under the affiliate transactions rules for the provision of services to those methods we currently use to value asset transfers. Under the rule adopted in this Order, when a carrier purchases from its affiliate services that are neither tariffed nor subject to prevailing company prices and such affiliate exists solely to provide services to members of the carrier's corporate family, the carrier would be required to value the transaction at the lower of fair market value and fully distributed cost. Under our existing valuation rules, however, such service transactions would simply be valued at fully distributed cost because insufficient third-party sales exist to substantiate a prevailing price for these services that are often tailored to the corporate family's unique needs. We conclude that these transactions where a carrier purchases from its affiliate services that are neither tariffed nor subject to prevailing company prices and such

[378] Id. § 272(b)(5).

affiliate exists solely to provide services to members of the carrier's corporate family should continue to be valued at fully distributed cost. We find that when an affiliate is established to provide services solely to the carrier's corporate family in an effort to take advantage of economies of scale and scope, the benefits of such economies of scale and scope are reflected in such affiliate's costs and are ultimately transferred to ratepayers through transactions with the carrier for such services valued at fully distributed costs. Requiring carriers to perform fair market valuations for such transactions would increase the cost to ratepayers while providing limited benefit.

iii. Fair Market Value

149. In the *NPRM*, we proposed to require carriers to make good faith determinations of fair market value, rather than specifying methodologies that carriers must follow to estimate fair market value, where such a valuation is required under the affiliate transactions rules.[379] We invited comment on this proposal. We sought comment on whether we should set criteria for determining what constitutes a good faith estimate of market value.[380] We also asked whether we should require carriers to support their valuations by reasonable and appropriate methods in situations involving transactions that are not easily valued.[381]

Comments:

150. Several State PUCs and TIA favor the adoption of the proposed good faith requirement on estimates of fair market value.[382] Most interexchange carriers, however, oppose its adoption.[383] MCI argues that adoption of the proposed good faith requirement would make it easier for the BOCs to shift costs.[384] Worldcom contends that the Commission should establish a uniform set of requirements for fair market value to apply to all the BOCs.[385] AT&T argues that, at a minimum, the Commission should apply the criteria

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379 NPRM, 11 FCC Rcd at 9094 para. 83.

380 Id. at para. 84.

381 Id. at para. 85.

382 TIA Reply at 22; Washington Reply at 6. See also NYDPS Comments at 9; Wisconsin PSC Comments at 7.

383 See AT&T Comments at 15-16; MCI Comments at 25-26; Worldcom Comments at 27.

384 MCI Comments at 25.

385 Worldcom Comments at 27.

discussed in the *NPRM*.[386] AT&T further asserts that the Commission should require a carrier that applies fair market valuation to a transaction to retain records documenting the methodology used in a form that would enable third parties to reproduce the analysis in the context of an audit or investigation.[387] TRA maintains that because transactions between a carrier and its affiliate do not involve a "willing" buyer and seller, the Commission should establish specific criteria to determine fair market value.[388] TRA asserts that the Commission should not allow carriers to use alternative valuation methods without obtaining a waiver from the Commission based on a clear demonstration of the alternative method's accuracy.[389]

151. GTE contends that purchases by unaffiliated companies provide an excellent benchmark because unaffiliated purchasers have no reason to pay unreasonably high prices.[390] In particular, GTE argues that if sales to unaffiliated companies of a product at a particular price generate large revenues then this is "strong evidence" that the price is "a valid price in market terms."[391]

152. While most of their objections appear to relate to the use of fair market value if the use of prevailing price is eliminated, USTA and several BOCs argue against a good faith requirement because of the difficulties in determining fair market value.[392] US West contends that there is no need to impose a good faith requirement on carriers.[393]

Discussion:

153. We find that the procedures carriers use in estimating fair market value should vary with the circumstances of each transaction. We consequently conclude that we should not specify the methodologies that carriers must follow to estimate fair market value where such a valuation method is required under the affiliate transactions rules. While many commenters

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386 AT&T Comments at 15-16; AT&T Reply at 11.

387 AT&T Comments at 15-16. See also TRA Comments at 17.

388 TRA Comments at 14-16. See also MCI Comments at 25-26.

389 TRA Comments at 16-17.

390 GTE Comments at 8.

391 Id.

392 See, e.g., BellSouth Comments at 33; SBC Comments at 34; USTA Comments at 18; NYNEX Reply at 13.

393 US West Comments at 18.

attack the use of fair market value generally in the affiliate transactions rules,[394] we find that no commenters have provided a sufficient reason why, having determined that fair market value should be used, we should not impose a good faith requirement. We believe that allowing carriers to make good faith determinations of fair market value, rather than prescribing specific methodologies, will provide them with the flexibility to use a methodology appropriate for the circumstances of the transaction. We find that the good faith requirement will help ensure that transactions involving a BOC and its section 272 affiliate satisfy the "arm's length" requirement of section 272.[395] We therefore adopt our proposal to require carriers to make good faith determinations of fair market value for purposes of our affiliate transactions rules. We further conclude that we should impose a good faith requirement on all affiliate transactions between an incumbent local exchange carrier currently subject to our affiliate transactions rules and any of its affiliates, not just to affiliate transactions involving the activities described in section 272(a).

154. While we decline to specify the methodologies that carriers must follow to estimate fair market value, we do set the baseline for a good faith determination of fair market value by requiring carriers to use methods that are routinely used by the general business community. For example, when carriers can estimate the market value of transactions using independent valuation methods, carriers should apply such methods to ascertain fair market value. Depending on the type of transaction, examples of methods for determining fair market values for both assets and services include appraisals, catalogs listing similar items, competitive bids, replacement cost of an asset, and net realizable value of an asset. We agree with GTE that sales to third parties can provide a benchmark and we conclude that if sales to third parties of a product at a particular price generate large revenues then the sale price is strong evidence of a good faith estimate of fair market value. When situations arise involving transactions that are not easily valued by independent means, we require carriers to maintain records sufficient to support their value determination. Specifically, the valuation method chosen by the carrier must succeed in capturing the available supporting information regarding the transaction and must utilize generally accepted techniques and principles regarding the particular type of transaction at issue. We note that nothing discussed here exempts carriers from their statutory obligation under section 220(c) to justify their accounting entries.[396]

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[394] See section IV.B.1.b.ii. and IV.B.1.b.iii., supra, for a discussion of the use of fair market value.

[395] 47 U.S.C. § 272(b)(5).

[396] Id. § 220(c).

iv. Tariffed-based Valuation

155. Under section 252, incumbent local exchange carriers may submit agreements adopted by negotiations or arbitration to State commissions for approval or rejection without filing a tariff.[397] Alternatively, they may file statements of generally available terms pursuant to section 252(f) that state terms on which these incumbent local exchange carriers would provide services to all customers who desire them.[398] In the *NPRM*, we sought comment on whether, and to what extent, our affiliate transactions rules should be amended to substitute rates appearing in such publicly filed agreements and statements for tariffed rates.[399] We also sought comment on whether such amendments would be consistent with, or required by, sections 272(e)(3) and 272(e)(4).[400]

Comments:

156. Most BOCs argue that the Commission should amend its affiliate transactions rules to allow them to use rates appearing in publicly filed agreements submitted to a State commission pursuant to section 252(e) or statements of generally available terms pursuant to section 252(f) in the place of tariffed rates.[401] NYNEX contends that such rates reflect "arm's length" transactions.[402] PacTel argues that because such rates will be subject to review by State regulators similar to tariff review, such rates provide the same protection against cross-subsidization.[403] Ameritech and USTA, however, argue that the Commission need not amend the affiliate transactions rules in this instance because under the current rules, BOCs must value transactions at either the prevailing price or cost, which would include rates filed in interconnection and collocation agreements.[404] SBC and TRA maintain that the Commission should allow BOCs to use terms contained in negotiated or arbitrated interconnection

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397 Id. § 252(e).

398 Id. § 252(f)(1).

399 NPRM, 11 FCC Rcd at 9095 para. 86.

400 Id.

401 See, e.g., BellSouth Comments at 35; NYNEX Comments at 29; PacTel Comments at 29; US West Comments at 19.

402 NYNEX Comments at 29.

403 PacTel Comments at 29.

404 See, e.g., Ameritech Comments at 23; USTA Comments at 24.

agreements or statements of generally available terms and conditions only to the extent a tariff is not available.[405]

157. Worldcom argues that amending the affiliate transactions rules to substitute rates appearing in such publicly filed agreements and statements for tariffed rates would be premature because the Commission has not yet proposed to eliminate the tariff requirements for BOCs' local exchange and exchange access services.[406] AT&T contends that such an amendment to the Commission's rules is unnecessary.[407] AT&T argues that section 272(b)(1)'s requirement that an affiliate operate independently from the BOC of which it is an affiliate prohibits any integration of exchange and interexchange facilities, including the purchase of interconnection and collocation services and network elements.[408] AT&T maintains that the Commission should prohibit BOC affiliates from offering any exchange service, except through total service resale at tariffed rates, and should require them to obtain all transmission capacity from the BOC pursuant to tariff as was the case under *Computer II*.[409]

Discussion:

158. We concur with the majority of BOCs that we should amend our affiliate transactions rules to allow incumbent local exchange carriers to use charges appearing in publicly-filed agreements submitted to a State commission pursuant to section 252(e) or statements of generally available terms pursuant to section 252(f) in the place of tariffed rates when tariffed rates are not available.[410] Because charges appearing in such publicly-filed agreements and statements are subject to State review, we find it unlikely that allowing incumbent local exchange carriers and their affiliates to record non-tariffed transactions using such rates when available would lead to the subsidization of competitive services by subscribers to regulated telecommunications services. Because carriers must comply with the cross-subsidization prohibitions of the Act regardless of what accounting rules we or the States adopt, neither a carrier nor its affiliate may use a charge appearing in publicly-filed

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[405] TRA Comments at 18-19; SBC Comments at 40.

[406] Worldcom Comments at 28.

[407] AT&T Comments at 16.

[408] Id.

[409] Id.

[410] See, e.g., BellSouth Comments at 35; NYNEX Comments at 29; PacTel Comments at 29; US West Comments at 19.

agreements or statements of generally available terms if the use of such charge would violate the Act. We do not believe that the fact we have not yet eliminated the tariff requirements for a BOC's local exchange and exchange access services forecloses us from establishing accounting safeguards now in anticipation of changes in the telecommunications market permitted by Section 252.[411]

159. We do not read section 272(b)(1)'s requirement that a BOC affiliate "operate independently" from the BOC so broadly, as AT&T suggests, that it prohibits all integration of exchange and interexchange facilities, including the purchase of interconnection and collocation services and network elements by such an affiliate.[412] We conclude that section 272(b)(1) does not prohibit BOC affiliates from receiving the same rates that any unrelated party could receive through publicly-filed agreements submitted to a State commission pursuant to section 252(e) or statements of generally available terms pursuant to section 252(f) instead of a tariffed rate.

v. Return Component for Allowable Costs

160. In the *Joint Cost Proceeding*, the Commission determined that fully distributed costs should include a return on investment, but no "profit" in excess of the return then prescribed for the carrier's interstate regulated activities.[413] Consequently, carriers that utilize fully distributed cost to value affiliate transactions include in their cost computations a component for rate of return. In the *NPRM*, we proposed that all carriers providing services subject to section 272 should use a uniform rate of return to determine the fully distributed costs associated with affiliate transactions.[414] The Commission has prescribed a unitary, overall rate of return for those incumbent local exchange carriers still subject to rate-of-return regulation to use in computing interstate revenue requirements, unless a carrier can show that

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411 But see Worldcom Comments at 28.

412 See Non-Accounting Safeguards Order at sections IV and VIII.

413 Joint Cost Reconsideration Order, 2 FCC Rcd at 6296 para. 119, 6298 para. 133, 6315 n. 203.

414 NPRM, 11 FCC Rcd at 9095 para. 87.